

Abilene
Acadiana
Anchorage
Canada
Colorado
Corpus Christi
Dallas
Fort Worth
Houston
Kansas
Michigan
Mississippi



New Mexico
New Orleans
Ohio
Oklahoma City
Oklahoma-Tulsa
Permian Basin
Rocky Mountain
San Antonio
San Francisco
San Joaquin
San Juan Basin
Wichita Falls

January 31, 2000

Mr. David S. Guzy
Chief, Rules and Publication Staff
Minerals Management Service
Royalty Management Program
P. O. Box 25165, MS 3021
Denver, CO 80225-0165

Dear Mr. Guzy:

RE: Establishing Oil Value for Royalty Due on Federal
Leases, Further Supplementary Proposed Rule, 64
FR 73820 (December 30, 1999)

The Council of Petroleum Accountants Societies (COPAS) appreciates the opportunity to comment on MMS' further supplementary proposal regarding valuation of oil from Federal leases. COPAS members have extensive experience with Royalty Management Program rules, handle royalty valuation, transportation, and processing allowances, adjustments, bills, audits, and other royalty matters on a regular basis. Therefore, we believe our comments will be beneficial in improving RMP processes for both the MMS and industry.

COPAS incorporates by reference our previous comments submitted to MMS regarding oil valuation from Federal leases.

COPAS' comments will address issues in the following areas: (1) Second Guessing, (2) Definitions, (3) Rocky Mountain Region Benchmarks, (4) Netback Valuation, (5) Transportation, (6) Binding Valuation Determinations, and (7) Administrative Burdens.

Second Guessing

Sections 206.102(c)(2)(A&B) and 206.110(a)(2)(A&B) contain language regarding second guessing a lessee's value in an arms-length transaction. COPAS commends MMS for including this provision in the rule but we remain concerned about the use of the term "unreasonably" in paragraph (B). This term is subjective and provides little guidance to the lessor or lessee. We recommend that the term "unreasonably" be changed to a less subjective word or that MMS provide criteria for what they would regard as unreasonable.

Mr. David S. Guzy
Page 2
January 31, 2000

Definitions

Affiliate - COPAS is concerned with the language in part (iii) and (iv) of this definition. This language along with language in the preamble regarding working interest owners and the discussion of "opposing economic interests" would seem to indicate that MMS is not going to regard the sale of oil by one working interest owner in a lease to another working interest owner in the same lease as an arms-length transaction. This indication is further enhanced in the preamble by the discussion on how a "designee" should value and report royalties to MMS. MMS stated in the workshops that this was not their intent and that MMS would regard these sales as arms-length. COPAS recommends that the intent of MMS be made clear by clarifying the preamble and adding language in 206.102 to specifically address this situation.

Area - This definition provides little, if any, guidance to either the lessor or lessee. We also note that the second benchmark in the Rocky Mountain Region requires determining the weighted average value of all sales from the field or area and all purchases within the field or area regardless of similar quality, economic, and legal characteristics; therefore, MMS' use of the term "area" in the second benchmark is inconsistent with their definition. COPAS recommends that MMS define area in a way which will be understood by both the lessor or lessee.

Rocky Mountain Region

COPAS has commented several times on the first benchmark, Tendering, and our opinion has not changed.

The second benchmark, volume weighted average gross proceeds, requires the lessee to trace their sales from the field or area. This is the only area of the regulations where the lessee is required to trace and does not have the option to use the index method if he can not or does not want to trace the oil dispositions. COPAS recommends that the Rocky Mountain Region lessees be given the same option as lessees in other areas. The most practical way to resolve this issue is to make the benchmarks a menu of options rather than a hierarchy.

Netback Valuation (Index Method)

COPAS still believes that the index method proposed by MMS is flawed for numerous reasons. For California MMS is using ANS spot prices and for other areas MMS is using spot prices at market centers, adjustment by location/quality. As currently proposed, the rule leaves many unanswered questions, a few of which follow:

- What if a lessee only exchanges a small portion of oil at a market center, do they use this differential for all of their oil?
- What does a lessee do if they do not exchange any oil at a market center or between ANS and the produced crude? Is MMS going to provide the differential? If the answer to this question is that MMS will provide the differential, where is MMS getting the expertise from to provide the differential?

Mr. David S. Guzy
Page 3
January 31, 2000

- What does a lessee do if there is not a quality bank on the pipeline?
- How will the MMS take into account when there is a quality bank but it is between two crudes more similar than the index and the produced crude? Will the MMS allow an adjustment for the remaining location / quality difference between the crude produced and the index starting point?

It appears to be a premise of the rule that lessees who exchange oil do so at a market center. COPAS does not believe that is necessarily true and the rule provides little guidance to lessees who do not have transactions at market centers or involving ANS. COPAS recommends that the rule be clarified to provide the lessees guidance in these situations.

Transportation

There are several areas where MMS has failed to provide guidance in Section 206.111. Some are as follows:

- On what basis does a lessee calculate depreciation if the transportation system has never been depreciated for MMS purposes? Is the system to be regarded as a new system? If so, what can a lessee use to show original capital investment if the records have been destroyed?
- For part 206.111(g)(3) what can lessee use to justify the ten percent (10%) if the original records have been destroyed?

COPAS recommends that the rule be changed to clarify these issues.

Binding Valuation Determinations

COPAS commends MMS for making a valuation determination binding on themselves and delegated states.

Part 206.107(a)(2) states that your request must identify the record title or operating right owners of those leases, and the designees for those leases. The lessee requesting a valuation determination may not know all this information and we are not sure why it is relevant. The lessee or designee requesting a valuation determination should only have to supply information in their possession and that is relevant to the request. COPAS recommends the rule be changed to these requirements.

Administrative Burdens

COPAS believes that MMS has underestimated the burden associated with requesting a valuation determination and requesting MMS approve a location/quality differential. If MMS is correct and there is not much trading activity from the Rocky Mountain Region to Cushing, we could see every lessee in the Rocky Mountain Region requesting multiple differentials from MMS. Also, MMS responded to numerous questions during the public workshop in Houston with "you would need to request a valuation determination." Based on these questions alone, there will be significantly more requests than the 1-2 monthly MMS has estimated.

Mr. David S. Guzy
Page 4
January 31, 2000

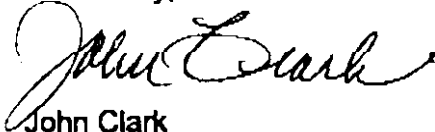
Also, MMS stated that they intend to publish a final rule March 15, 2000 with an effective date of June 1, 2000. This is insufficient time for lessees who have to implement MMS' index method to implement system changes or to hire and train employees if the work must be done manually. In addition, many lessees will be seeking approval of location / quality differentials. Time should be allowed for this to occur. Going forward with payments on an estimated basis just creates additional burdens on companies and the MMS. It also creates additional disputes when payments cannot be made correct the first time. COPAS would recommend an effective date of no earlier than June 1, 2001 to allow lessees to implement systems changes or hire additional staff to handle the manual work effort.

Conclusion

Based on the number of questions MMS received from lessees who might be implementing the index method, COPAS believes there is significant confusion amongst these lessees on the meaning of the rule related to their individual circumstances. COPAS hopes MMS will address the concerns raised in the public comments and make changes in the final rule to reduce the lessees' confusion and uncertainty.

COPAS appreciates the opportunity to provide comments to this proposed rule. If you have any questions or would like to further discuss these comments, please contact John Clark at (580)767-5044.

Yours truly,



John Clark
COPAS Revenue Standing Committee Chairperson

mdb

cc:

Doyle Wofford, COPAS President

Darrell Gingerich, COPAS Revenue Committee Board Liaison